A Comprehensive Solution for a Targeted Problem: A Critique of the EU’s Home State Taxation and CCCTB Initiatives

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I. Introduction

To date, the process of economic and political assimilation in the EU has been the most active political and regulatory response to the brave new world of global market integration. It represents a zenith in policymakers’ recognition that recent material changes in the world economy require fundamental adjustments to the political structure of states. EU Member States are the trailblazers of change and, as such, the manner by which they approach and resolve their integration quandaries is bound to reflect on future developments in the international arena.

In this context, the EU’s corporate income tax policy is particularly revealing. Over the last generation, the European Community and the subsequent EU have been remarkably successful in removing impediments to free trade among Member States. This resulted in an accelerated level of economic integration and allowed the emergence of pan-European markets and corporate structures.1 In sharp contrast to its ability to harmonize its monetary policy and remove trade barriers, however, the EU’s failure to implement an effective harmonization of its Members States’ income tax systems is considered the Achilles heel of its strive for economic integration.2 Despite most Member States lowering their corporate tax rates and broadening their tax bases during the 1990’s, this largely uncoordinated sequence of initiatives did not take the sting out of many tax barriers faced by investors in the common market.3

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1 ROLF DIEMER & THOMAS NEALE, The European Union's Longer-Term Plans for Introducing a Common Consolidated Tax Base for the EU-wide Activities of Companies, 89 Cahiers de droit fiscal international 69, 71 (2004).
Accordingly, some commentators consider the development of an EU (business) income tax policy as vital to achieving the EU's goal of economic integration.\(^4\)

The central role that taxes play in the political and economic arenas has led to what may be understood as a tradition of national chauvinism with regard to tax policy. An attempt to overcome this legacy, by formulating an effective corporate tax policy, can be seen as a test of the EU's ability to attain meaningful economic integration. The EU's recent enlargement, moreover, has opened a window for meaningful reforms in tax policy. The need to integrate a great number of new Member States, some with very poor traditions of tax administration, into the EU market system may prove a constitutive moment. This window of opportunity, however, may soon draw to a close. Once this reconstruction momentum dies down, it is possible that EU tax policy will be crippled into a status quo deadlock due to interest group politics.\(^5\)

This Article's emphasis on the acute need for rethinking EU corporate tax policy justifies a greater discussion of the unique function of corporate taxation. Scholars widely recognize that the corporate form is the most important investment vehicle for transnational investments. Corporate tax is also believed to be a progressive component in the finance of the state (this is especially true in the EU, where consumption and wage taxes comprise a significant part of the tax mix).\(^6\) The friction between the different roles of the corporate income tax makes it the melting point of income tax policy in our era. The manner by which these inherent complexities are resolved in the EU in the next few years may very well impact the manner by which income tax policy develops in response to globalization.

This need for reconsideration is relevant now more than ever before. Recently, the British government issued a detailed proposal for altering its international tax regime from a credit to an exemption system.\(^7\) Britain is the major EU economy that (still) taxes the worldwide income of its residents. If this reform takes place, it can have radical consequences. In addition, the United States is considering shifting to a more territorial regime and may soon follow in Britain’s steps. If these two major economies were to shift to a territorial system, other countries are likely to soon follow, resulting in what may become a domino effect of territorial taxation. Once this landslide begins, and residence taxation diminishes, policymakers may find that current sourcing conventions cannot bear the enormous pressure laid upon them to measure and tax income comprehensively. Because the EU is at the forefront of contemporary sourcing debate, Member States and other countries will be relied upon to carefully examine for whom the EU bells would ring—and their future actions will be determined accordingly.

This Article focuses on how the EU corporate tax regime should be reformed. It critically analyzes the current proposals for reform and offers its own alternative model.

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\(^4\) The European Council set a strategic goal that the EU becomes the most competitive, dynamic and knowledge-based economy in the world. See Point 5 of the Presidency Conclusions from the Lisbon European Council, 23 and 24 March 2000.


Part II explains the tax obstacles that the simultaneous operation of twenty-seven tax systems imposes on attempts to make the EU economy more efficient and competitive. It further outlines the EU Commission's (hereinafter, "the Commission") strategy to reduce these obstacles. Part III provides a detailed description and a critical assessment of the fourth proposal, the Home State Taxation initiative (hereinafter, "the HST initiative"), generally considered the only proposal that may become operational in the foreseeable future. This Article demonstrates why it should nevertheless be rejected, or limited significantly. In Part IV, this Article briefly explores the Common Consolidated Corporate Tax Base initiative (hereinafter "the CCCTB initiative"). It concludes that while the CCCTB is better than the HST initiative, both proposals share some fundamental deficiencies. There are doubts, however, about whether the CCCTB will become operational in the near future. Part V delineates the Article's proposal for desirable corporate income tax reform in the EU. It promotes the core idea that broad incremental reforms, such as the HST, reduce—rather than increase—the chances of achieving overall comprehensive unitary reform of the entire EU corporate income tax. Instead of advocating for these reforms, this Article argues that the Commission should provide one comprehensive unitary reform in a hard-to-tax sector, such as the financial, technology and IP-intensive or shipping-and-aviation sectors. Part VI compares this Article's proposal with the HST initiative. Through this comparison, this Article draws out the principles through which a transitory regime might correspond with the long-term objective of comprehensive EU corporate tax reform. Part VII provides some brief conclusions.

II. The Issue in Context: The EU Corporate Tax Strategy

A. A Tax Perspective of Economic Integration

Policymakers wishing to reform the EU’s corporate tax policy operate in difficult terrain. International taxation is a field in which unilateralism is rarely an option. A single sovereign wishing to reformulate its tax system is often required to embark on lengthy treaty amendment processes or be exposed to retaliation by other sovereigns. Moreover, it is difficult to facilitate an effective common action with regard to the EU’s income tax policy. There is a firm commitment, entrenched in the EU’s constitutive treaties, that any initiative related to direct taxation is to go through strict procedural process and must attain unanimous agreement from all Member State representatives in the EU Council for Economic Affairs.8 The federative nature of the EU seems to prescribe that Member States are to retain some control over the rates, subsidies and expenditures associated with the corporate tax under any future tax reform.

There are two political impediments to forming a unified EU corporate tax policy. First, most of the pressure for a unified EU taxation comes from the bureaucratic ranks of the Commission and from the judicial interpretations of EC law by the European Court of Justice (hereinafter, "the ECJ") rather than from the business community. Lacking active business pressure and support from Member

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States, the Commission finds it difficult to politically mobilize such large-scaled tax reform.

Second, it is difficult for Member States to align with the Commission's plans, since so many aspects of these plans are unclear. While a number of objectives are repeatedly emphasized in all of the Commission's initiatives (e.g., enhancing transparency), the Commission has yet to figure out what the ultimate level of coordination should be and how much competition it aspires to promote.

A situation in which twenty-seven different national corporate tax regimes operate simultaneously within a supposedly internal market gives rise to differential effective tax costs on similar commercial activities taking place within that market. These cost differences jeopardizes the mobility of investments within the internal market and conflicts with the ambition for a fully integrated and competitive market.

The ongoing cross-border integration of markets and the enhanced mobility of the means of production (e.g., capital and intangible assets) intensify the threat of tax—as well as other types of regulatory—competition. The existence of many different tax regimes allows investors to tax-shop among jurisdictions to minimize their tax liabilities. Member States thus have incentives to structure their tax systems so as to attract certain types of investments and activities. The different tax costs on different taxpayers or economic activities are often considered to be the distortive and inequitable dark side of the EU's economic integration. Recently, this tension between economic integration and the sustainability of the income tax base has surfaced in a number of ECJ rulings. In those rulings, the ECJ concluded that a number of Member States' anti-avoidance tax regimes discriminate against foreign investments in a way that infringes upon the freedom of establishment.

**B. Tax Obstacles Imposed on EU Integration by the Twenty-Seven Separate Accounting Corporate Tax Regimes Operating Within it**

When a country employs a separate accounting tax system, it, in a sense, ring-fences the income-producing activities taking place in its jurisdiction. When an economic unit operates in multiple jurisdictions, the attempt to assign some of its income to a specific jurisdiction has two main implications. First, under the separate accounting system, the economic activity is measured in accordance with the tax base and the tax accounting conventions of the jurisdiction to which it is attributed (even if it is conducted by a non-resident). Second, and more importantly, the activity is appraised separately from related economic activities carried out by the same economic entity in different jurisdictions. Accordingly, every separate accounting system has its own transfer pricing rules for bifurcating integrated economic activity.

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11 DAVID WILLIAMS, Freedom of Establishment and Double Taxation Agreements, 19 European Law Review 313 (1994) (discussing a case in which the ECJ decided that the anti discrimination rationales have precedent over DTTs).
occurring in more than one jurisdiction. Nevertheless, all jurisdictions use some form of the arm's-length standard to source related-party transactions. Generally, the arm's-length standard employs a hypothetical inquiry as to how unrelated parties would price a certain transaction, and requires each corporate entity within a Multinational Enterprise (hereinafter, “MNE”) group to report accordingly. However, the arm's-length standard, as it is currently enshrined in a plethora of transfer pricing regulations, is a conceptually flawed, practically inept, and extremely inefficient and burdensome mechanism to source many complex affiliated transactions.12

Unlike confederative nations, Member States’ income tax base rules and tax accounting principles lack a general uniformity. The existence of twenty-seven separate sets of tax-accounting rules contradicts the EU’s goal of forming an integrated and competitive internal market. Furthermore, it imposes some tax-costs on taxpayers operating in more than one Member State, creating a bias in favor of domestic investment. This set of penalties on cross-border operations creates four types of problems.13 First, European MNEs and tax authorities must invest considerable amount of resources to allocate profits and losses arising from related parties' transactions. These transfer pricing costs are a major source of concern because the volume of affiliated transactions within integrated MNE business structures is only increasing.14

Second, MNEs operating in the EU are unable to fully attain intra-group income tax consolidation that would be otherwise available for corporate groups with solely domestic operations. This inability to consolidate losses, and the excessive realization of profits in cases of corporate reorganization, impose severe tax distortions on the efficient allocation of resources and the choice of business structure.15 Following the ECJ's Marks & Spencer ruling there has been some development in this area; however, MNEs are still unable to fully consolidate their losses.

Third, European MNEs are forced to spend vast resources to comply with each domestic tax regime and its associated double taxation treaties.

Fourth, in cases of cross-border corporate reorganizations, European MNEs may still incur excessive tax costs associated with the realization of profits from appreciated assets.

14 EU COMMISSION, Taxation Papers: European Tax Survey 64-5 (2004); EU COMMISSION, Towards and Internal Market Without Tax Obstacles: A Strategy for Providing Companies with a Consolidated Corporate Tax Base for their EU-Wide Activities (2001) (stressing that there is a concrete concern that companies which are making bona fide attempts to comply with complex and often conflicting transfer-pricing regimes are penalized by them); EU COMMISSION, Company Taxation in the Internal Market SEC(2001)1681 261-8 (2001) (mentioning that transfer-pricing was mentioned as the most important issue for business representatives and that due to the lack of unaffiliated transactions to which one may compare aggressive transfer-pricing auditing often result in double taxation on the one hand and manipulation on the other).
15 EU COMMISSION, Company Taxation in the Internal Market SEC(2001)1681 249-52 (2001) (suggesting that there is significant evidence that the lack of consolidation results in the over taxation of European MNEs).
16 ECJ, 13 December 2005, Case C-446/03, Marks & Spencer plc v. David Halsey (Her Majesty’s Inspector of Taxes).
Although the incongruence among the different tax regimes discriminately imposes tax-related compliance costs against international investments, it also opens a wide array of tax reduction opportunities for well-advised taxpayers. Such taxpayers exploit inconsistencies in tax rules to engage in planning, arbitrage-seeking and avoidance activities.\(^{17}\) The different effective tax rates and deficient transfer pricing rules allow MNEs to shift income to low-tax jurisdictions. Thus, as the next Part of this Article discusses, tax-related costs mainly affect small and medium sized enterprises. These businesses bear tax costs when they expand to other Member States, but are unable to use rule inconsistencies to reduce their overall tax liability.

### C. The Role of the Commission in Formulating a Tax Reform Strategy

In a breakthrough study published in 2001,\(^ {18}\) the Commission outlined a strategy to deal with the above-mentioned obstacles. This strategy has two main pillars. First, the Commission stressed the desirability of establishing a European corporate tax regime with a uniform consolidated tax base in which the core tax accounting unit is the MNE itself.\(^ {19}\)

The second pillar relates to the Commission's strategy to relax the tax obstacles it identified. Its biggest dilemma was whether to endorse large-scale corporate tax reform or to support small incremental reforms. While the payoffs of the former are considerably greater, its political costs are enormous. The Commission proposed to deal with this problem by distinguishing between targeted and comprehensive remedies.\(^ {20}\) While the first—targeted remedies—tailors a specific remedy for each problem, the second—comprehensive remedies—seeks to facilitate a major change in Member States' tax systems and to encompass a remedy for all of the obstacles identified in the 2001 study. The Commission emphasized that it would promote both types of remedies.\(^ {21}\)

This Article focuses on two of the targeted remedies that the Commission set forth—the HST initiative and, to a lesser extent, the CCCTB initiative. In particular, it examines the interrelationship between the HST initiative's objectives and the longer-term solution of a comprehensive EU corporate tax regime.

The Commission presented the HST and CCCTB initiatives as two of four alternative proposals for corporate tax consolidation.\(^ {22}\) Even though the Commission presented all four as comprehensive solutions, both the HST and CCCTB initiatives should be regarded as (temporary) targeted solutions. All four proposals, however, have their merits and drawbacks.

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recognize the need to create appropriation formulas to allocate the revenues of this newly formulated MNE tax-base among Member States. This common thread reflects on the Commission’s conscious decision not to rely its long-term tax reform on arm’s-length sourcing techniques associated with separate accounting.

The Commission has decided to promote the CCCTB initiative and has formed a working group to make it operational. However, as discussed in Part VI, formulating a comprehensive corporate income tax base and establishing allocation mechanisms that would apply to almost all EU corporations is complicated. Reaching political agreement on this issue is even harder. Thus, even though the CCCTB would be optional—that is, MNEs could choose whether to comply with it or with existing rules—the CCCTB is far from being operational. The HST initiative is currently being examined in a pilot study conducted by the Commission. The Article, therefore, devotes much of its analysis to describe and critically analyze it.

III. The HST Initiative

Unlike the other three proposals, the HST initiative is not a purely source-based corporate tax reform but one that involves an amalgam of source and residency tax-considerations. Additionally, unlike the other three proposals, it did not originate from the Commission but from the joint writings of two prominent European tax scholars: Sven-Olof Lodin and Malcolm Gammie.23 The Commission, however, limited the scholars’ proposal and restricted its application only to small and medium business enterprises (hereinafter, SMEs).

To fully understand the HST initiative, one must first understand the disproportional tax burdens faced by SMEs engaged in cross-border business activities. Although SMEs comprise the spinal-column of the EU economy,24 their participation in cross-border activities is considerably lower than larger corporations,25 in part because of the grave burden imposed by tax obstacles. SMEs are subject to proportionally higher tax compliance costs than large corporations.26 They also lack the ability of larger MNEs to shift income through tax planning because they have lower capital reserves and access to expertise.27 Additionally,

24 EU COMMISSION, Annex to the Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee Tackling the Corporation Tax Obstacles of Small and Medium-Sized Enterprises in the Internal Market – Outline of a Possible Home State Taxation Pilot Scheme SEC(2005) 1785 6, 15-6 (2005) (pointing out that 99% of entities in the internal market are SMEs and that they employ 66% of the workforce in the EU, and provides detailed figures about their importance to the internal market).
26 EU COMMISSION, Taxation Papers: European Tax Survey 4 & 37-8 (2004) (mentioning that compliance costs for medium firms is around 30% of their taxes paid, in comparison for about 2% for large companies, and that the compliance costs are much higher for those companies engaged in cross-border investments).
some start-up SMEs in the technology driven sector are particularly sensitive to the inability to consolidate losses during the first years of operation.\textsuperscript{28} All these factors meaningfully hinder the integration of the internal market and its competitiveness. The Commission thus adopted the HST initiative to provide a remedy for the distortive burden placed upon SMEs that operate (or wish to operate) in more than one Member State.\textsuperscript{29} It was viewed as a quickly attainable and politically favorable remedy that did not have the agreement costs necessary for fundamental reformation of existing tax rules.\textsuperscript{30}

The HST initiative offers an elective system to both Member States and SMEs based upon the principle of mutual recognition by tax authorities.\textsuperscript{31} In Member States that join the HST initiative, SMEs could choose to file tax returns in their country of residence, under the nation’s applicable tax rules, for their operations in all of the participating Member States.\textsuperscript{32} Thus, under the HST initiative, affiliated cross-border transactions would be subject to withholding taxes. Although the HST initiative does not prescribe unitary treatment of the MNE, SMEs electing to file tax returns under it are more likely to be residents in countries that allow group consolidation. For this reason, this Article avoids discussing the unique set of problems that emerge when the HST initiative is implemented in unconsolidated settings.\textsuperscript{33}

Where MNEs do consolidate their profits, their net income, as computed by the country of residence, will be divided among the participating Member States by an agreed-upon payroll- and/or turnover-based appropriation formula.\textsuperscript{34} The income allocated to each jurisdiction will be subject to the statutory corporate tax rate


\textsuperscript{29} EU COMMISSION, Outline of a Possible Experimental Application of Home State Taxation to Small and Medium-Sized Enterprises (2004).


\textsuperscript{31} This would include the treatment of foreign income, the administration of the tax filing process, the definitions of income and the corporate consolidation rules. SABINE D. SELBACH, The Harmonization of Corporate Taxation & Accounting Standards in the European Community and their Interrelationship, 18 Conn. J. Int'l L. 523, 530 (2003).


\textsuperscript{33} In those cases where the MNE subject to the HST is not consolidating profits there is an additional source of difficulty with the treatment of foreign income. See: CHARLES E. MCLURE, Corporate Tax Harmonization in the European Union: The Commission's Proposals, 36 Tax Notes Int'l 775, 793 (2004) (pointing out that imposing the country of resident's foreign tax law on foreign subsidiaries may result in over or under taxation of those subsidiaries).

\textsuperscript{34} EU COMMISSION, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Tackling the Corporation Tax Obstacles of Small and Medium-Sized Enterprises in the Internal Market – Outline of a Possible Home State Taxation Pilot Scheme 23-4 (2005). If the HST initiative adopts payroll as a sole factor, this decision may have very problematic implications. Payroll does not take into account wage and consumption power differentiations in different countries. Tax authorities will find it difficult to define, and consistently implement, a comprehensive unitary system without a careful comprehensive definition of what comprises an employee for unitary tax purposes.
applicable to that jurisdiction. MNEs operating in sectors subject to specific tax rules (e.g., financial services and shipping) are excluded from the HST initiative.\(^\text{35}\) The definition of eligibility is one attribute of the HST initiative in which the residence state is denied any type of discretion. The HST initiative allows companies to participate in it only if they employ fewer than 250 employees, have an annual turnover of less than 50 million euros, or carry a balance sheet of less than 43 million euros.\(^\text{36}\) Furthermore, the HST initiative would be supplemented with an agreed-upon tie-breaker rule with regard to corporate residency determinations and a general anti-avoidance rule that restrains the ability of participating MNEs to engage in residency-shopping and tax-motivated expatriation.

The revenue impact of adopting the HST initiative is not entirely clear and would depend upon both the formulary design and the number of Member States and corporations that opt to participate in it.\(^\text{37}\) It is nevertheless expected to remove tax-induced foreign investment barriers on SMEs, in a manner that would lead to greater competitiveness, economic integration and welfare in the EU.\(^\text{38}\) In light of the low current levels of SME participation in cross-border enterprises, there seems to be general agreement that the ease and speed of implementing the HST initiative are its true virtues and that there is really little to lose by offering the HST initiative option to SMEs.

The HST initiative seems to take the middle path between the Commission's targeted and comprehensive agendas. It targets the SME sector and tries to incorporate some unitary aspects in its taxation. Even though it incorporates these unitary features, the HST initiative is not perceived as a comprehensive solution, but rather as a remedy to the SMEs' existing difficulty in operating within the common market. This perception, in light of its middle path approach, is interesting because the unitary alternative is typically associated with the Commission's ambition to promote a comprehensive long-term corporate tax regime rather than a targeted remedy. Given this perception, this Article inquires about whether the HST initiative helps to promote a long-term, comprehensive EU corporate tax regime.

This Article’s evaluation of the HST initiative distinguishes among critical assessments directed at the initiative’s principled decision to shift away from separate accounting methods towards a unitary method and explores the difficulties that are unique to the HST. This Article mainly deals with the latter discussion.

The HST initiative attempts to implant a unitary system in an international arena that subscribes to separate accounting norms. Tax authorities may find it

\(^{35}\) EU COMMISSION, Outline of a Possible Experimental Application of Home State Taxation to Small and Medium-Sized Enterprises 5 (2004).


\(^{37}\) In a simulation conducted using data from SMEs in Sweden, only a slight revenue loss of revenue was reported, which was attributed to the (desirable) ability of SMEs to better consolidate their losses under the HST initiative. EU COMMISSION, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Tackling the Corporation Tax Obstacles of Small and Medium-Sized Enterprises in the Internal Market – Outline of a Possible Home State Taxation Pilot Scheme 11 (2005).

difficult to prevent profit-shifting and reduce administrative costs when MNEs that
elect to consolidate under HST programs have foreign operations in non-HST
countries. This Article focuses on those flaws that result from the HST initiative's
unconditional embrace of residence jurisdictions' tax bases, which is a futile attempt
to ameliorate source taxation by highlighting the importance of tax residency.

First, and most noticeably, the HST initiative envisions the simultaneous
operation of multi-unitary systems (on top of the existing separate accounting
systems). This notion of tax-regime plurality undermines the HST initiative’s main
objective: to reduce tax compliance and administrative costs. For example, it would
force parties to litigate domestic cases with reference to foreign law, involve
complicated and arbitrary tax computation in cases of a change in corporate
residency, and necessitate excessive cooperation among tax authorities in audits and
investigations.39

Second, the anti-avoidance rule suggested by the HST initiative may be
effective in preventing direct tax-motivated corporate expatriations. Nevertheless, it
is unlikely to be effective with regard to newly established enterprises or corporate
mergers and acquisitions that result in a change of corporate tax residency.

Third, the adoption of the HST initiative may result in massive tax
distortions.40 The HST initiative does not elaborate on how its adoption by a number
of Member States is supposed to lead to any form of voluntary (or rapid) tax base
convergence of their tax systems. Without such convergence, taxpayers with similar
economic incomes that are located in the same residence and/or source jurisdiction
may be subject to completely different effective tax rates.41 Put differently, the HST
is likely to perpetuate tax distortions on investments within the internal market.42
Furthermore, the fact that corporate residency is essentially a legal fiction could help
induce tax-base competition among states to attract companies into their
jurisdictions.43

Finally, it is common knowledge that electability in tax rules is a type of
bonus for those businesses engaged with tax planners and/or tax haven jurisdictions.44
For instance, assume there are two Member States, both of which are low tax
jurisdictions (e.g., Ireland and Luxemburg). One of those jurisdictions may aim to
join the HST framework to engage in headquarter/residency tax-base competition.
The other may elect not to participate to allow income-shifting to affiliated
subsidiaries located in its jurisdiction. Tax planners may choose to allocate the
corporate residency in a country with a favorable tax base (e.g., in a country that

39 VIERI CERIANI & SILVIA GIANNINI, Trends in EU Proposals on Taxation of Transnational Business
Profits and Tax Coordination, 2003 WTD 178-11 (2003); PETER BIRCH SORENSEN, Company Tax
40 JOANN MARTENS WEINER & JACK MINTZ, An Exploration of Formula Appportionment in the
41This differentiation of effective tax rates, especially on the source jurisdiction, may put in question
the political viability of the proposal. BJORN WESTBERG, Consolidated Corporate Tax Bases for EU
wide Activities: Evaluation of four Proposals Presented by the European Commission, see id. at 322
XX333; CHARLES E. MCLURE, Corporate Tax Harmonization in the European Union: The
42 VIERI CERIANI & SILVIA GIANNINI, Trends in EU Proposals on Taxation of Transnational Business
43 SABINE D. SELBACH, The Harmonization of Corporate Taxation & Accounting Standards in the
44 BJORN WESTBERG, Consolidated Corporate Tax Bases for EU wide Activities: Evaluation of four
that by definition elective regimes invites planning).
exempts foreign income and employs relatively lax transfer-pricing rules, has a favorable treaty network, calculates depreciation at accelerated rates, etc.). This could be done simultaneously with the shifting of income (through “traditional” debt financing and transfer-pricing loopholes) to a subsidiary located in another low-tax jurisdiction that is not participating in the HST arrangement. If this subsidiary is a resident of a Member State, it would enjoy the protections of the EU parent, as well as, the interest and royalties directives that the parent benefits from. While general anti-avoidance rules may be useful to circumvent bluntly artificial transactions, careful tax planning would put most of these structures within the gray area that is beyond the effective reach of these rules.

The assumption that the revenue impact of the HST initiative will be minimal should be reconsidered. Member States with high-tax jurisdictions that will take part in the HST initiative may have their corporate tax base significantly stripped. Through simple tax planning, SMEs would be able to reduce their taxable earnings in jurisdictions with high corporate taxes, even though those high-tax jurisdictions will still enjoy the privilege of imposing their relatively high statutory tax rates.

To conclude, the Commission's decision to promote the political feasibility of the HST initiative came at the cost of conceding the legitimacy of some of its flaws. Allowing the barbarians within its walls, the HST initiative may result in severe revenue loss and fail to relieve tax compliance and administrative burdens. Moreover, if adopted, the HST initiative may actually jeopardize the EU’s progress toward adopting a comprehensive unitary tax system. Its flaws may erode the political legitimacy for a unitary solution and consume too much of the Commission's tax expertise. The HST initiative’s wide array of distortions will provide incentives to form taxpayers' lobbies, making it difficult for the Commission to advance the solution of a comprehensive unitary system. Because of these flaws, the HST initiative is indefensible in its current format.

For the HST initiative to be justified, the Commission must significantly lower its costs by limiting the HST regime to small businesses. The HST solution is suitable for cases where a coffee-shop owner in Baarle-Hertog (Belgium) wishes to open a coffee shop across the street in Baarle-Nassau (Netherlands). Because of its abuse potential, the HST initiative is not suitable for businesses of a larger scale. A start-up company that subscribes to the HST initiative, while being a resident of Luxemburg but operating a research center in Germany and a production line in France, may cost the treasuries of France and Germany a lot of revenue. Since the HST initiative offers a transitory solution, its negative impact on the chances of attaining greater comprehensive tax harmonization in the future is one of its major weaknesses.

IV. The CCCTB Initiative

Under the CCCTB initiative, Member States would allow MNEs within them to elect whether to report all of their operations under a single, consolidated, EU corporate tax base. The initiative does not require MNEs to make the election, and they can choose to continue using the twenty-seven separate accounting systems instead. The net income of the group would be allocated by an appropriation formula. MNEs participating in the CCCTB may choose to give up the tax benefits of shifting income in return for the ability to consolidate their losses and relieve their transfer-pricing compliance burden. The Commission has considered recently tying a tax

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reform similar to the CCCTB to its European company (the Societas Europaea) initiative.45

The other two comprehensive proposals advocated by the Commission’s 2001 study are basically stricter mandatory versions of the CCCTB.46 The adoption of these stricter versions would remove tax-obstacles on economic integration more effectively than the CCCTB. However, because they are mandatory, they require profound levels of harmonization and cooperation. Therefore, these two more comprehensive proposals are unlikely to gain Member States’ support in the current political atmosphere. Although both proposals provide Member States with tax rate flexibility, Member States are unlikely to agree to completely harmonize their tax bases.

The CCCTB initiative is operational because of its optional nature. Consequently, however, it suffers from this fundamental weakness; it tries to simultaneously advance both tax uniformity and the taxpayers’ choice to elect whether they want to be subject to it. Accordingly it has two main drawbacks: First, it requires intensive cooperation and agreement among Member States that desire to offer such uniformity. Even on the most superficial level, one has to recognize that formulating an all-encompassing corporate tax base involves a lot of difficult-to-agree-upon technical aspects.47 Many of the difficulties are not merely technical, but also represent deeply rooted ideological tax policy divisions. It is therefore difficult to see how Member States could reconcile many of the issues that this type of corporate-base formulation raises in the near future.48 Moreover, like the other

45 The Commission’s idea was that the Societas Europaea may be used as a platform for adopting a consolidated common European tax base. This consolidated tax base is supposed to be both a pilot for a European corporate tax system and an incentive to lure European companies to incorporate under the new status. However, since this initiative is still in very inchoate and preliminary stages the Article refrains from addressing it in length. See MALCOLM GAMMIE, EU Taxation and the Societas Europaea - Harmless creature or Trojan Horse?, 44 see id. at 3, 37-9 (2004(; EU COMMISSION, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee: An Internal Market Without Company Tax obstacles Achievements, Ongoing Initiatives and Remaining Challenges 24 (2003).

46 Both are mandatory and require broader base harmonization. Like the CCTB, both would allow cross-border loss consolidation, and thus would require an agreed upon allocation formula. The European Union corporate income tax (hereinafter, "the EUCIT") proposal would impose a corporate tax on the EU rather than the national level. This would eliminate the need for existing national tax bases. The new corporate tax would be administered and collected by an EU organ and not by Member States. The more radical version of this proposal would also require a uniform tax rate. The other proposal, known as the Harmonized Tax Base (hereinafter, "the HTB") would apply to all business enterprises. Under this proposal, each Member State would determine its tax rates and administer the tax. However, unlike the EUCIT proposal, the HTB proposal does not require any central European tax administration.

47 EU COMMISSION, Common Consolidated Corporate Tax Base Working Group (CCCTB WG) Progress to Date and Future Plans for the CCCTB 15 (2006( (mentioning that the working groups did not discuss the treatment of intra-group dividend payments); EU COMMISSION, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Implementing the Community Lisbon Programme: Progress to Date and Next Steps Towards a Common Consolidated Corporate Tax Base (CCCTB) 8, 11 (2006) (mentioning that experts from different countries seem to prefer what they know and an annex showing the initial stages of the discussions on virtually all topics); EU COMMISSION, Common Consolidated Corporate Tax Base Working Group (CCCTB WG) - CCCTB: Possible Elements of a Technical Outline (2007) (giving a broad overview of all the issues the CCCTB requires to settle and demonstrating the complexity of the matters at stake).

48 EU COMMISSION, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Implementing the Community Program for Improved Growth and Employment and he Enhanced Competitiveness of EU Business :Further
proposals, the CCCTB requires devising a formulary allocation mechanism that is very different from the arm’s-length transfer pricing regimes that Member States currently employ. The Commission (justly) regards the ability to consolidate losses as one of the CCCTB initiative’s main benefits. This loss consolidation is not possible without an allocation mechanism. Because the CCCTB would apply to almost all types of EU companies, the revenue impact of these decisions would be immense. Member States will find it difficult to reach agreements on these issues, given the high stakes involved.49

Second, taxpayers can elect whether they are subject to the CCCTB, which means that, even if it is adopted by the Commission, multiple tax systems would still operate simultaneously. As in the case of the HST initiative, this means that neither the administrative and compliance costs, nor the concerns over tax avoidance are likely to be significantly reduced by the CCCTB initiative. MNEs tend to be sophisticated and well-advised taxpayers that do not mind spending resources on tax planning if they perceive them as worthy investments. Therefore, it seems naïve to think that MNES would elect the CCCTB unless it reduces their overall costs. Although adopting the CCCTB would reduce their compliance costs, to the extent that it would increase their effective tax rate, they would not choose it. The CCCTB may indeed raise the effective tax rate if it succeeds in meeting the Commission’s objectives of limiting MNEs planning and income-shifting possibilities and broadening the corporate tax base.50

This fundamental inconsistency in the CCCTB limits its potential advantages and reduces its feasibility. Therefore, this Article believes that the CCCTB, currently, has limited prospects in forwarding the Commission’s integration objectives. Accordingly, the rest of this discussion focuses on comparing this Article’s proposal with the HST initiative. As elaborated in the previous Part, the agreement costs for the HST initiative are low. This explains why the Commission regards “the concept

Progress during 2006 and next steps towards a proposal on the Common Consolidated Corporate Tax Base (CCCTB) 6-7 (2007) (discussing the difficulty in reconciling different tax preferences of Member States and in determining and administrative framework for the proposal); EU COMMISSION, Common Consolidated Corporate Tax Base Working Group (CCCTB WG) Progress to Date and Future Plans for the CCCTB 16 (2006). 49 This part of the CCTB project is in its early stages. See EU COMMISSION, Common Consolidated Corporate Tax Base Working Group (CCCTB WG) Progress to Date and Future Plans for the CCCTB 18 (2006); EU COMMISSION, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Implementing the Community Lisbon Programme: Progress to Date and Next Steps Towards a Common Consolidated Corporate Tax Base (CCCTB) 6 (2006); EU COMMISSION, Common Consolidated Corporate Tax Base Working Group (CCCTB WG) Report and Overview of the Main Issues that Emerged During the Discussion on the Sharing Mechanism SG6 second meeting – 11 June 2007 at http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/C CCTBWP056_en.pdf (stressing out the different problems and considerations that should be taking into account when adopting sharing mechanisms).

50 The Commission wishes to promote a broad CCCTB tax base. EU COMMISSION, Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: Implementing the Community Program for Improved Growth and Employment and the Enhanced Competitiveness of EU Business: Further Progress during 2006 and next steps towards a proposal on the Common Consolidated Corporate Tax Base (CCCTB) 6 (2007). Member States will impose their corporate tax rates on corporations that chose to file under the CCCTB. If the CCCTB tax rate is indeed broader than the one of most Member States the effective tax rate of MNEs may increase unless Member States provide CCCTB filers with a special reduced tax rate.
of Home State Taxation… to be a very promising way of tackling the tax problems that hamper SMEs when they are expanding across borders.\[51\]

V. The Article’s Proposal: Unitary and Formulary Taxing of the Hard-to-Tax

This Article portrays a different strategy that the Commission should promote in its efforts to attain its goals of a European corporate tax regime that includes a harmonized base, loss consolidation, and unitary tax-allocation methodology. It suggests doing so by providing a comprehensive solution to a targeted problem. Unlike the Commission’s comprehensive solution, this Article's solution entails a reformulation of how a specific sector or activity should be taxed through a formulary or unitary system. The limited scope of this Article’s reformulation is intended to make its proposal more politically feasible. It suggests that the Commission should employ a mandatory, unitary sourcing regime on one of the hard-to-tax-sectors as a pilot for a comprehensive unitary solution. This strategy would allow the Commission and Member States to gradually implement the European unitary solution and to avoid the unpredictable groundswell of radical reform. While this Article does not pretend to offer any spotless textbook solutions, it opts to propose a politically feasible strategy, which, unlike the HST and CCCTB initiatives, would be able to get a foothold on the path toward a comprehensive unitary solution.

Current separate accounting and sourcing arrangements fail because they attempt to trace and assign ownership of mobile assets to specific corporate entities and jurisdictions. This is an attempt to adhere to obsolete legal forms, which are alien to the business models that it is supposed to tax. In economic reality, where MNEs share risks and interests with respect to the mobile assets they hold, create, and utilize, endorsing specific corporate ownership—rather than MNE ownership—of financial and intangible assets would be both obsolete and hazardous. \[52\] Such an endorsement allows MNEs to utilize their current exceptional capacity to exploit the international tax system. This, in turn, amplifies the demand for tax-competitive behaviors from sovereigns and promotes tax base erosion.

As a response to these concerns, this Article argues for a dual sourcing regime. The cornerstones of this regime are the following: (1) every type of tangible transaction (or function) for which a reasonable market comparable exists should be sourced in accordance with the arm’s-length standard (as previously suggested, preferably according to the CPM method); (2) other types of transaction or functions (e.g., intangibles-related transactions; transaction involving mobile and easy-to-manipulate MNE resources, such as financial resources) should be sourced according to formulary methods that rely on immobile indicators. The underlying theme of both cornerstones is that sourcing should be done by a standardized proxy. This proxy should be determined according to tangible indicators that demonstrate where MNE activities are taking place, thus indicating where their profits have been generated. Although sourcing by such immobile proxies certainly raises some obvious concerns,


\[52\] Elizabeth Chorvat, Forcing Multinationals to Play Fair: Proposals for a Rigorous Transfer Pricing Theory, 54 ALABAMA L. REV 1251 (2003) (conveying a different opinion that tax authorities could use advanced risk assessment methods to breakdown the intra-MNE capital formation and risk allocation).
it would perform better than the present system in halting MNEs’ ability to shift income.

In two earlier Articles, I developed the idea of a dual sourcing regime that prescribed formulary sourcing of the income MNEs derive from financial and intangible-related transactions. More specifically, I argued that for MNEs operating in the financial sector (hereinafter FMNEs), there is good reason to switch to a full-scale unitary system. The reason is that FMNE income is comprised almost entirely of income related to financial activities. Because financial activities and assets are mobile and tax sensitive, the arm’s-length transfer-pricing paradigm simply falls apart when implemented on these financial Goliaths. Tax authorities simply do not have sufficient resources to effectively audit the huge volume of sophisticated affiliated FMNE transactions in accordance with the arm’s-length standard. Moreover, in the case of financial transactions, tax authorities also lack a conceptual paradigm to determine what an arm’s-length standard is. Financial engineering allows these well-advised taxpayers to construct their capital flows through an infinite number of instruments. Thus, economically similar positions may have completely different tax consequences when carried through different financial instruments.

This Article argues that the Commission should adopt a comprehensive FMNE unitary system or any other comprehensive system that would unitarily source a hard-to-tax-sector as the first strategic step of reforming the EU corporate tax. Under the FMNE unitary system, FMNE earnings would be allocated according to the volume of economic activity they have in each jurisdiction. This volume would be determined according to two factors: tangible property and compensation for labor. Both these factors are immobile and relatively easy for tax authorities to assess.53

This Article does not wish to pretend that this unitary sourcing solution, as any other unitary sourcing solution, is a simple one. It does not discuss the proposal itself with great detail, but rather highlights the key issues that are relevant in the EU context. This Article’s unitary proposal strives for uniformity in all key elements other than tax rates.54 Therefore, the unitary system would have to operate under a single set of uniform rules that determine the scope of the income tax base, the tax accounting rules that define the appropriation formula factors, and the composition of the formula. More importantly, the unitary system should be administered by a centralized agency, probably a branch of the Commission, which would be responsible for its coherent and transparent implementation. For the purposes of this Article, it is not necessary to elaborate upon the precise set of rules that would comprise the income tax base and tax accounting conventions. Almost any uniform set of reasonable and broad-base rules would involve fewer compliance costs and abuse possibilities than the twenty-seven sets of tax rules currently employed. The political costs of agreement required by such uniformity are discussed in the next Part.

A number of problems may result from attempting to implement a unitary solution in an insufficiently integrated political setting. First, and most notably, the emphasis of the suggested formula on labor compensation as a benchmark for sourcing is problematic due to the different wage structures in various Member States. To actively promote such a proposal, the Commission has to control for the different

costs of living and the different price levels in different Member States. This would provide incentives for the new (and poorer) Member States to support the proposal. The proposal’s emphasis on the importance of the payroll factor also poses significant political problems, because tying the sourcing of FMNEs to the payroll imposes an implicit tax on labor. Given the high unemployment rates in many Member States, it would be difficult for the Commission to persuade them to impose such a tax.

Second, another source of difficulty with this Article's proposal is its attempt to place a multinational unitary system within an international tax regime based on a decentralized network of bilateral tax treaties. These treaties subscribe to a number of soft-law principles that adhere to the concepts of separate tax accounting and arm’s-length sourcing. The vast majority of FMNEs in question would have non-European branches and subsidiaries. In the absence of an agreement on the international level, the transactions affiliated with these branches and subsidiaries would be sourced by traditional separate accounting mechanisms. This would require the FMNE taxing authority to employ a single set of transfer pricing rules to source these transactions. The unitary rules would also have to include a set of uniform CFC and thin capitalization provisions.

Under the unitary system, internal flows of capital resources within the European components of the FMNEs would be completely flexible and free of tax costs. If one assumes that no single set of withholding taxes could be attained (because of Member States' double taxation treaty obligations with third countries), it is crucial to develop some mechanism of sourcing foreign operations to avoid severe problems of treaty shopping. This requires the Commission to implement some

56 VICTOR ZONANA, International Tax Policy in the New Millennium: Developing an Agenda, 26 Brooklyn J. Int'l L. 1253, 1254 (2001). There are a number of alternative approaches to this problem. A first approach will allow this jurisdictional shopping. This approach may open a too wide of a planning hole in many of the Member States' tax systems. This in turn could endanger the integrity of the unitary system. A second approach would determine a quasi corporate residency rule and attribute all the foreign transactions for withholding tax purposes to it. Although this may seem as an easy and practical solution, its clinging to the residency benchmark is wasteful and antithetical to the enterprise of formulating a unitary system and thus it should be rejected. A third approach would attribute FMNEs foreign related activities according to a formula. Under this approach, the volume of foreign transactions that would be attributed to each of the FMNEs' jurisdiction would be determined in accordance with the relative level of activity in that geographic location. The level of activity will be determined in accordance with the relative income share of each jurisdiction. For example, assume a European FMNE, operating in the UK and Germany. In a given fiscal year (any type of time framework could be used for this purpose) 70% of the FMNEs income was attributed to the UK and 30% to Germany. During that year it paid 1000 euros as dividends to its American Parent. In this scenario the amount of dividend attributed to the UK and Germany for withholding tax purposes would be 700 and 300 euros, respectively. Albeit this solution is feasible, it does require separate accounting for different types of foreign transactions. This sheds a shadow of doubt whether the Article's proposal would succeed in attaining its ambitions of compliance burden reduction and simplification. The answer to this question is a factual one, which largely depends on the relative weight of EU transactions v. foreign transactions in European FMNEs activities. It is nevertheless crucial to recognize that under the current separate accounting systems, taxpayers are not only require to hold separate accounting methods for financial transactions within Europe but also have to deal with twenty-seven different rules of how to keep those accounts.
57 For instance, assume an FMNE operating in the UK, France, the Netherlands and Germany. Further assume that this FMNE wishes to conduct business with an affiliated (or non-affiliated) company in a non EU tax haven jurisdiction, which has a favorable tax treaty with the Netherlands. In a unitary setting, there is basically nothing to prevent it from channeling many of its transactions through the Netherlands to obtain the most tax efficient results.
type of anti-avoidance rule. However, even if the Commission does not advance such a rule, the proposal will still be valid because it is not supposed to provide a flawless alternative but rather only a better one. Since the current anti-treaty shopping arrangements are by and large ineffective, FMNEs already freely channel their financial flows to attain the best available withholding tax treatment.

The EU has a long history of tax competition with regard to financial activities. The Commission's earliest initiatives recognized that tax differentiation in the effective taxation of financial intermediaries is one of the biggest tax obstacles in preventing a liberalized and efficient allocation of capital. If subject to a harmonized tax system free of cross-border obstacles, European capital markets will become more centralized in their management, more flexible in the way they allocate their resources, and more competitive. By that same token, if nothing changes, it is also clear that as the economic integration of European financial markets advances, EU taxpayers and tax-authorities will witness a growth in compliance, administrative, planning and avoidance costs—all of which are costs inherent to maintaining twenty-seven different tax systems. The financial sector is unique because it deals solely with mobile intangible assets. Furthermore, financial engineering allows taxpayers to reach equivalent economic positions through different types of legal contracts. Therefore, in many cases these assets do not have market comparables because there is no one correct way of structuring financial transactions. While taxing FMNEs through a unitary setting is by no means a panacea, it over-performs the current use of twenty-seven separate accounting regimes to source FMNEs. The growth in the volume of FMNE affiliated financial transactions and their complexity, the anticipated growth of the FMNE business sector, the significant deadweight of the international transfer-pricing regime, and the current inequities in the distribution of revenue all indicate that adopting the Article’s suggested unitary reform is worth its transition and uncertainty costs. This conclusion resonates with the growing recognition of both policymakers and members of the financial industry that any EU corporate tax reform should include the financial sector as well.

VI. General Attributes of the EU Strategy Towards Implementing Unitary Taxation

The Commission has embraced the first few steps on the long road towards unitary taxation. Most importantly, it recognized the arm’s-length standard's limited prospects and the need to shift its tax policy emphasis from problems of harmful tax competition and adequate pricing methodologies to the core problems of revenue allocation within an integrated market. This Article does not wish to open an in-depth discussion of the well known unitary v. arm’s-length debate. It does, nevertheless,
wish to engage in a meaningful discussion regarding the strategy of attaining a comprehensive unitary EU corporate tax regime.

In an attempt to elicit the principles necessary to attain unitary reform in the EU, this Part compares the proposal of the HST initiative with that advocated by this Article. Both proposals share some common features. First, both depart from the traditional wisdom of international tax law policymaking. Rather than refining highly factitious ad hoc pricing mechanisms, such as the APA arrangements and the profit-split transfer-pricing methodologies, both proposals seek to provide a unitary default rule targeting affiliated-transaction sourcing hurdles.

Second, each proposal applies only to a relatively small, yet significant, sector. By limiting their scope, the proposals bypass the problem inherent to the CCCTB initiative, which requires policymakers to agree upon an inclusive corporate income tax base and formula. This limited nature of the Article’s proposal and the HST initiative seems necessary to avoid the conceptual difficulty of writing a new corporate income tax base. More importantly, this limited nature enhances the political feasibility of the proposals and allows both proposals to avoid the potential groundswell of overall corporate tax reform. The sectors on which the two proposals focus are similar, in the sense that the separate accounting systems contained in each leads to grave (albeit different) fallouts.

Third, both proposals promote efficiency in their respective sectors, since they reduce problems of double taxation and tax distortions associated with MNEs organizational and finance structures.

Fourth, both proposals reduce (but not eliminate) the compliance and administration problems associated with transfer pricing and thin capitalization.

Fifth, by employing a consolidated tax base along with a unitary allocation system, both proposals reduce biases against foreign investments. By doing so, both proposals highlight the connection between the unitary solution and the removal of tax obstacles slowing European market integration.

Finally, the problems both proposals entail can be traced to a similar source: the attempt to insulate a certain unitary activity in an arm’s-length world.

The most fundamental difference between the proposals is the tradeoff they make with regard to the costs of the political agreements necessary for a smoothly functioning unitary system. The proponents of the HST initiative choose to avoid these costs by allowing multiple unitary systems to coexist and by making the proposed regime electable. In contrast, the Article's proposal emphasizes the need for a uniform mandatory regime, which entails significant costs for formulating a single FMNE income tax base, uniform tax accounting principles and, most importantly, a single European FMNE tax administration.

When evaluating the two proposals, it is important to recognize that both offer some type of transitional tax regime. This point suggests that the proposals should be primarily evaluated in terms of how well they promote the Commission's final goals. This Part's analysis explores whether the enhanced agreement costs required by this Article's proposals are indeed an investment worth making.

This point should be answered on a number of different layers, according to the different evaluation criteria for multinational tax reform.

A. Compliance costs—Although having a single unitary tax is beneficial for a great number of reasons, the primary benchmark for its success is its ability to reduce
compliance and administrative costs. Any departure from the status-quo entails a set of potential losers. Accordingly, it is important that the proposed unitary change reduces all parties’ compliance and administrative burdens. This type of Pareto improvement in compliance and administrative cost reduction is the main guarantee for the reform’s viability. On these terms, this Article’s proposal is more successful, because it provides a uniform and therefore easier tax regime to administrate and with which to comply.

B. Fiscal viability—Another benchmark by which the proposals should be evaluated is their ability to provide solid revenue grounds in an era of tax competition and exceeding fiscal obligations. In this respect, it is worth noting that both proposals could increase tax competition tendencies. Unitary taxation essentially is a territorial system, which taxes business profits only once at the source. Thus, implementing it without any type of tax-rate coordination increases the risk of a tax-competitive race to the bottom among Member States seeking to attract investments by reducing corporate tax rates and increasing cash/tax subsidies. However, the adoption of the HST initiative jeopardizes a different sort of tax-base competition. The tax-base competition under the HST initiative would allow Member States, which seek to attract corporate headquarters to their jurisdictions by narrowing corporate tax bases, to reduce the effective tax rates of other Member States by exporting their own tax advantages. This type of competition is arguably more pernicious since it is less transparent, and thus requires less political accountability. Furthermore, the electability of the HST initiative is in many senses a license for tax avoidance. The enhanced friction points among its different systems enable SMEs to engage in tax planning and to seek tax arbitrage. In contrast, this Article's proposal offers a more sensible method of allocation under which the effective tax rate in each jurisdiction is determined by the level of economic activity in a respective location, and not by the country of its corporate residence.

C. Learning externalities—Both proposals aim to initiate a wider process of unitary corporate taxation in the EU. Thus, the Article assesses both proposals with respect to the institutional knowledge the Commission is expected to gain from their implementation. The HST is fundamentally different from any comprehensive unitary corporate tax solution the Commission may seek to promote, so there is little operational knowledge that could be gained by facilitating it. In sharp contrast, this Article's proposal offers a longstanding solution to the problem associated with sourcing FMNE affiliated transactions. If a comprehensive EU unitary solution is eventually established, industries with unique characteristics, such as the financial sector, may still require a unique formula. Thus, the political and administrative

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63 Id. at 231. (pointing that electability of a tax regime is antithetical with the ambition to reduce tax related compliance and administrative burdens)
66 Id. at 285.
resources invested in promoting this Article's proposal will not be in vain once the Commission begins mobilizing the process of attaining a more comprehensive solution. More significantly, the proposal provides the Commission and Member State tax authorities with the necessary institutional knowledge to combat the difficulties of delineating and operating a unitary system. Implementing the unitary sourcing solution in the limited financial sector setting will allow tax policymakers to control the transition costs of shifting to a unitary system. Accordingly, the costs of establishing the uniformity required under this Article's proposal should be seen as an investment towards future benefits in the pursuit for a comprehensive tax solution.

D. Political learning—The institutional experience of having a centralized FMNE tax authority is crucial. Most tax disputes involve a national tax authority and a taxpayer. However, in the context of this Article’s discussion, tax disputes are most likely to arise among tax authorities. In light of this insight, policymakers should remember that the adoption of the HST initiative would create a cleft in Member States’ tax systems. This Article's proposal helps promote the idea that no cross-border European tax reform is possible so long as Member States are not willing to reform their own tax systems. This Article's proposal prevails over the HST initiative because Member States need to internalize the need for a centralized authority, rather than mutual recognition of one another’s tax systems, to remove tax obstacles. It also promotes a more transparent multinational tax regime that would enhance political accountability (of the Commission, Member States, and lobbying groups) to delineating tax policy. This would require tax authorities to address the revenue and distributive impacts of having a unitary system. The FMNE unitary system is an avenue by which the EU could address these issues, which are likely to play a vital role in its attempts to self determine its profile as a political entity.

E. National fiscal sovereignty—One of the core obstacles in the implementation of an EU unitary system is the intuitive link Member States make between national fiscal sovereignty and separate accounting systems. This, of course, is an illusion. This conception of fiscal sovereignty is very formalistic, and therefore inconsistent, with the notion of substantive fiscal sovereignty in an internal market. In reality, Member State tax regimes intertwine so intimately that their tax policy decisions are unquestionably dependent on each other. Through coordination, states can sustain a reasonable and reliable flow of revenues. This would enable them to achieve a higher level of control in developing more equitable public-financing systems and governmental expenditure schemes. In contrast, when divided, Members States are ruled by the prisoner's dilemma and coerced to subordinate their national fiscal considerations to global market forces. Both the HST and this

72 JACK M. MINTZ, National Tax Policy and Global Competition, 56 Brooklyn Journal of International Law 1285, 1296 (2001); KAREN. BROWN, Allowing Tax Laws to Cross Borders to Defeat International
Article's proposals threaten the myth that separate accounting promotes fiscal sovereignty. However, the HST initiative is in many senses a double-edge sword. On the one hand, it allows Member States to maintain their autonomy with respect to their ability to shape their own tax bases. On the other hand, the HST initiative reduces the actual ability of Member States to exercise control over the taxation of commercial activities in their own source jurisdiction. Moreover, sovereign power to tax is lost in favor of other unaccountable political processes taking place in other Member States. Consider the following example. [A] is a Member State that elects to participate in the HST regime. [A], which has a service-driven economy, implements accelerated depreciation rules for heavy machinery. The major impact of these rules would be borne by Member States with industry-driven economies participating in the HST regime. Corporate residents of country [A] may elect to file tax returns using the benefits of these accelerated depreciation rates in other source jurisdictions. This Article's proposal grants each Member State the ability to participate in the political process that generates the tax rules to which it would be subjected under the proposal. Just like any other type of common action, this type of subordination to a decision-making process is the only avenue open to Member States to enhance their substantive fiscal sovereignty.

VII. Conclusions

The EU tax policy is at a crossroad where it has to decide whether to take the path of integration. This Article suggests that although the Commission has promulgated its endorsement of corporate income tax integration, the initiatives it took, namely the HST initiative, show that this endorsement was half-hearted at the very best.

We are living in an age in which the power of domestic tax authorities have become considerably smaller than the scope of the transactions, income-producing activities, institutions, and markets that these tax-authorities are supposed to efficiently and equitably tax. The CCCTB initiative entrenches and the HST initiative even enhances the difference among various EU tax regimes. This Article’s proposal promotes targeted comprehensive reform in one of the hard-to-tax sectors, such as the financial sector. This is a politically feasible strategy that allows the EU to start the process of converging the different European tax regimes into a single EU corporate income tax regime.

There is an old Hasidic fable about an ageing father who had two sons. He did not know which one of them should take his place in managing the family farm and decided to test them by giving them a task. He showed each of them a different parcel of land which had one large boulder in it and a lot of small rocks. He told them that to cultivate the land both parcels should be clear by the next day. The older son spent half of the day clearing the rocks. Once he finished, he was already a bit tired and the task of moving the boulder looked so great that he decided to postpone it to the next

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day. The younger son started the day by moving the boulder – it took him half a day of hard work to push it out of the parcel’s boundaries. Once he completed that part of his task moving the rocks was more like a rest for him. Accordingly, he finished clearing the parcel in that same day and replaced his father in managing the farm.

By choosing to advance the HST initiative, the Commission has chosen to move the small rocks first. This strategy begs the question of whether the task of moving the big boulders blocking the road to EU corporate income tax integration would be feasible at all. This Article’s strategy, on the other hand, starts with a big boulder; it requires more effort and political risk-taking, but it is bound to be more rewarding.